

Internal Revenue Service

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Washington, DC 20224

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, ID No.

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Date:
August 20, 2014

Legend

Decedent -
Trust -
Beneficiary -
Date 1 -
Date 2 -
Date 3 -
A -
B -
Court -
Charity -
X -
Y -

Dear :

This letter responds to your letter dated February 12, 2014, and prior submissions, requesting rulings concerning the reformation of a trust under § 2055(e)(3) of the Internal Revenue Code.

On Date 1, Decedent created a revocable trust, Trust. Under Article Third, upon the death of Decedent, the trust income is payable equally to Decedent's mother, if living, and to Beneficiary. Upon the death of the survivor, Decedent's mother or Beneficiary, the trustees are to distribute the remaining trust assets to Charity. Article Third also provides that it is subordinate to Article Sixth. Under Article Sixth, the Decedent's executor or administrator may request funds for: (1) estate, transfer, inheritance, legacy and succession taxes by reason of Decedent's death; (2) debts of the Decedent and funeral expenses; and (3) all legacies payable by the executor under Decedent's will. Decedent's mother predeceased Decedent. Decedent died testate on Date 2.

Under Article First of Decedent's will, Decedent's executor was authorized to exercise, to the extent as he shall deem necessary or desirable, the rights given to him under Article Sixth of Trust. Under Article Eleventh of the Will, Decedent devised and bequeathed the remainder of his estate to Trust.

Trust does not qualify for the estate tax charitable deduction under § 2055(a) because Trust is not a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT) within the meaning of § 664(d)(1) or (d)(2). On Date 3, to qualify Trust for the estate tax charitable deduction, the executor of Decedent's estate and trustees of Trust filed a petition for reformation in Court to reform the Trust under § 2055(e)(3) in order to qualify Trust as a charitable remainder unitrust described in § 664(d)(3). Date 3 is within 90 days after the last date (including extension) for filing Decedent's estate tax return. Upon receipt of a favorable private letter ruling, the executor and trustees propose to amend the original complaint and seek the Court's approval of the reformation.

As proposed, Trust will be reformed to create a charitable remainder unitrust (CRUT) and an administrative trust (A-Trust). Trust, as reformed, provides that the first day of the unitrust period is the date of Decedent's death, and the last day of the unitrust period is the date of death of Beneficiary. During the unitrust period, the trustee is to distribute in quarterly payments X percent of the net fair market value of the trust valued annually on the first day of each taxable year. The unitrust amount is to be distributed A percent to Beneficiary and the balance, B percent, to Charity. Upon expiration of the unitrust term, the trustee is to distribute all of the principal and accrued but undistributed income of Trust, free of trust, to Charity. The unitrust recipients entered into a settlement agreement reflecting the proposed reformation.

Upon reformation, \$Y from Trust will be transferred to the CRUT. The remaining Trust property will be transferred to A-Trust. At the completion of the estate administration and the payment of all the estate expenses from A-Trust, the trustees will transfer the remaining A-Trust assets to the CRUT.

Your authorized representative has requested the following rulings:

1. The interest created in Article Third of the Trust is a "reformable interest" within the meaning of § 2055(e)(3).
2. The proposed reformation will result in a qualified reformation of the Trust, within the meaning of § 2055(e)(3)(B).
3. A deduction under § 2055(a) will be allowable for the present value of the remainder interest of Trust, as proposed.

4. The unitrust amount payable to charity under the terms of CRUT, as proposed, will constitute a fixed percentage within the meaning of § 2055(e)(2)(B), and a federal estate tax charitable deduction under § 2055(a) will be allowed for the present value of this interest.

5. The CRUT will be a charitable remainder unitrust effective on Date 2.

Law and Analysis:

Section 664(d)(2) provides, in relevant part, that a CRUT is a trust: (A) from which a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in § 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals; (B) from which no amount other than the payments described in § 664(d)(2)(A) and other than qualified gratuitous transfers described in § 664(d)(2)(C) may be paid to or for the use of any person other than an organization described in § 170(c); (C) following the termination of the payments described in § 664(d)(2)(A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in § 170(c) or is to be retained by the trust for such a use; and (D) with respect to each contribution of property to the trust, the value (determined under § 7520) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

Section 664(d)(3) provides that notwithstanding the provisions of § 664(d)(2)(A) and (B), the trust instrument may provide that the trustee shall pay the income beneficiary for any year — (A) the amount of the trust income, if such amount is less than the amount required to be distributed under § 664(d)(2)(A), and (B) any amount of the trust income which is in excess of the amount required to be distributed under § 664(d)(2)(A), to the extent that (by reason of § 664(d)(3)(A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

Section 1.664-1(a)(4) of the Income Tax Regulations provides that, in part, in order for a trust to be a charitable remainder trust, it must meet the definition of and function exclusively as a charitable remainder trust from the creation of the trust.

Section 1.664-1(a)(6), Example 1, provides as follows: On September 19, 1971, H transfers property to a trust over which he retains an intervivos power of revocation. The trust is to pay W 5 percent of the value of the trust assets, valued annually, for her life, remainder to charity. The trust would satisfy all the requirements of § 664 if it were irrevocable. For purposes of § 664, the trust is not deemed created in 1971 because H is treated as the owner of the entire trust under subpart E. On May 26, 1975, H

predeceases W at which time the trust becomes irrevocable. For purposes of § 664, the trust is deemed created on May 26, 1975, because that is the earliest date on which H is not treated as the owner of the entire trust under subpart E. The trust becomes a charitable remainder trust on May 26, 1975, because it meets the definition of a charitable remainder trust from its creation.

Section 1.664-1(a)(6), Example 3, provides as follows: The facts are the same as in Example (1), except that the residue of H's estate is to be paid to the trust and the trust is required to pay H's debts. The trust is not a charitable remainder trust at H's death because it does not function exclusively as a charitable remainder trust from the date of its creation which, in this case, is the date it becomes irrevocable.

Section 1.664-1(a)(6), Example 4, provides as follows: (i) In 1971, H transfers property to Trust A over which he retains an inter vivos power of revocation. Trust A, which is not a charitable remainder trust, is to provide income or corpus to W until the death of H. Upon H's death the trust is required by its governing instrument to pay the debts and administration expenses of H's estate, and then to terminate and distribute all the remaining assets to a separate Trust B which meets the definition of a charitable remainder annuity trust. (ii) Trust B will be a charitable remainder trust from the date of its funding because it will function exclusively as a charitable remainder trust from its creation. For purposes of § 2055, Trust B will be deemed created at H's death if the obligation to pay the annuity amount begins on the date of H's death. For purposes of § 664, Trust B becomes a charitable remainder trust as soon as it is partially or completely funded. Consequently, unless Trust B has unrelated business taxable income, the income of the trust is exempt from all taxes imposed by subtitle A of the Code, and any distributions by the trust, even before it is completely funded, are governed by the rules of § 664. Any distributions made by Trust A, including distributions to a recipient in respect of annuity amounts, are governed by the rules of subchapter J, chapter 1, subtitle A of the Code other than § 664.

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2055(a) provides that, in part, for purposes of the federal estate tax, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, and transfers to or for the use of religious, charitable, scientific, literary, or educational organizations described in § 2055(a)(1) through 2055(a)(4).

Section 2055(e)(2) provides that where an interest in property (other than an interest described in § 170(f)(3)(B)) passes or has passed from the decedent to a person, or for a use, described in § 2055(a), and an interest (other than an interest which is extinguished upon the decedent's death) in the same property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the

decedent to a person, or for a use, not described in § 2055(a), no deduction shall be allowed under § 2055 for the interest that passes or has passed to the person, or for a use, described in § 2055(a), unless — (A) in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)), or (B) in the case of any other interest other than a remainder interest, such interest is in the form of a guaranteed annuity, or is a fixed percentage distributed yearly of the fair market value of the property (to be determined yearly).

Section 2055(e)(3) provides for the reformation of interests to comply with the requirements of § 2055(e)(2). Section 2055(e)(3)(A) provides that a deduction shall be allowed under § 2055(a) in respect of any qualified reformation.

Section 2055(e)(3)(B) defines the term “qualified reformation” to mean a change of a governing instrument by reformation, amendment, construction, or otherwise that changes a “reformable interest” into a “qualified interest,” but only if — (i) any difference between (I) the actuarial value (determined as of the date of the decedent’s death) of the qualified interest, and (II) the actuarial value (as so determined) of the reformable interest does not exceed 5 percent of the actuarial value (as so determined) of the reformable interest; (ii) in the case of (I) a charitable remainder interest, the nonremainder interest (before and after the qualified reformation) terminated at the same time, or (II) any other interest, the reformable interest and the qualified interest are for the same period; and (iii) the change is effective as of the date of the decedent’s death.

Section 2055(e)(3)(C)(i) defines the term “reformable interest” to mean any interest for which a deduction would be allowable under § 2055(a) at the time of the decedent’s death but for § 2055(e)(2).

Section 2055(e)(3)(C)(ii) provides that the term “reformable interest” does not include any interest unless, before the remainder vests in possession, all payments to persons other than an organization described in § 2055(a) are expressed either in specified dollar amounts or a fixed percentage of the fair market value of the property.

Section 2055(e)(3)(C)(iii) provides, in part, that § 2055(e)(3)(C)(ii) does not apply to any interest if not later than 90 days after the last date (including extensions) for filing an estate tax return, if an estate tax return is required to be filed, a judicial proceeding is commenced to change the interest into a qualified interest.

Section 2055(e)(3)(D) defines the term “qualified interest” to mean an interest for which a deduction is allowable under § 2055(a).

In this case, the charitable remainder interest constitutes a reformable interest under § 2055(e)(3)(C)(i) because as originally drafted, Trust provides for a charitable

remainder interest that is presently ascertainable and, hence, severable from the noncharitable interests. Prior to the enactment of § 2055(e)(2), such interests would have been deductible under § 2055(a). See § 20.2055-2(a) of the Estate Tax Regulations. Although the payments to Beneficiary were not expressed in specified dollar amounts or a fixed percentage of the fair market value of the property as required by § 2055(e)(3)(C)(ii), a judicial proceeding was commenced, as provided under § 2055(e)(3)(C)(iii), before the 90th day after the last date (including extensions) for filing Decedent's estate tax return.

Further, the reformation satisfies the requirements of § 2055(e)(3)(B)(i), (ii) and (iii) because: (1) the difference between the actuarial value (determined as of the date of the Decedent's death) of the qualified interest and the actuarial value (as so determined) of the reformable interest does not exceed 5 percent of the actuarial value (as so determined) of the reformable interest; (2) the nonremainder interest terminates at the same time both before and after the reformation; and (3) the reformation is effective as of the date of Decedent's death.

Further, we conclude that the payment of estate taxes and administrative expenses, from A-Trust, as reformed, will not cause the CRUT to fail to qualify as a charitable remainder trust under § 664 and the regulations thereunder.

Accordingly, based on the information submitted and representations made, we conclude that the reformation of Trust, as described above, will be a qualified reformation within the meaning of § 2055(e)(3), provided the reformation is effective under local law, and provided the trust, as reformed, meets the requirements for a charitable remainder unitrust under § 664(d)(2) and (3) and the applicable regulations. Assuming the CRUT otherwise qualifies as a charitable remainder unitrust, Decedent's estate will be allowed a federal estate tax charitable deduction under § 2055(a) for the present value of the charitable remainder interest of the CRUT and the B percent payable to Charity.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express no opinion as to whether the CRUT as reformed, qualifies as a charitable remainder unitrust under § 664(d)(2) and (3) and the regulations thereunder. See Rev. Proc. 2014-3, 2014-1 I.R.B. 111, section 4.01(35).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Lorraine E. Gardner
Senior Counsel
Branch 4
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure

Copy for § 6110 purposes

cc: